United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

74-1969-2366

To be argued by
PETER K. LEISURE

B P/S

United States Court of Appeals

FOR THE SECOND CIRCUIT

IIT, an International Investment Trust, and GEORGES BADEN, JACQUES DELVAUX and ERNEST LECUIT, as Liquidators for IIT, an International Investment Trust,

Plaintiffs-Appellees-Cross-Appellants,

—against—

VENCAP, LTD., INTERVENT, INC., INTERCAPITAL, N.V., RICHARD C. PISTELL, CHARLES E. MURPHY, JR., DAVID TAYLOR and HAVENS, WANDLESS, STITT & TIGHE,

Defendants-Appellants-Cross-Appellees,

and

WALTER BLACKMAN,

and

ROBERT L. VESCO, MILTON F. MEISSNER, NORMAN LeBLANC and STANLEY GRAZE,

Defendants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF DEFENDANTS-APPELLANTS CHARLES E. MURPHY, JR., DAVID TAYLOR and HAVENS, WANDLESS, STITT & TIGHE IN REPLY TO THE *AMICUS CURIAE* BRIEF OF THE SECURITIES & EXCHANGE COMMISSION

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United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket Nos. 74-1969, 74-2366

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Preliminary Statement

Defendants-appellants Charles E. Murphy, Jr. ("Murphy"), David Taylor ("Taylor") and Havens, Wandless, Stitt & Tighe ("Havens Wandless") submit this brief in response to the brief on appeal filed by the Securities and Exchange Commission ("SEC") as *amicus curiae*. By motion dated March 11, 1975 the SEC sought leave to file an *amicus curiae* brief in support of plaintiffs-appellees. That motion was granted by this Court per the Honorable William H. Timbers on March 18, 1975. Pursuant to Judge Timbers' order, defendants-appellants were permitted to file a response to the SEC brief no later than March 24, 1975 at 4:00 P.M. In order to avoid undue burden on this Court which would result from the filing of duplicative briefs by the other defendants-appellants herein, said defendants-appellants join in the instant response to the SEC brief.

The SEC's View of the Facts

The SEC has relied heavily upon the facts as stated in the brief of plaintiffs-appellees (the "IIT brief"). As a result of its reliance upon the IIT brief, the SEC has been misled by plaintiffs into repeating many of the unsupported statements and misstatements contained in the IIT brief.

Only the most glaring misstatements of fact made in the *amicus* brief will be commented upon herein.

The SEC's Contention: Defendant Pistell is a resident of the United States.

The Facts: At all times relevant to this appeal, Pistell was a resident of the Bahamas and the record is clear and uncontradicted in this regard (A1192a, 1194a, 1196a, 1962a). The district court specifically so found (A950a). Defen-

dants' briefs are equally clear on this point, which was not in dispute in the court below.*

The SEC's Contention: Pistell is the controlling shareholder of Vencap.

The Facts: There are three shareholders of Vencap—Pistell, Walter Blackman, and IIT. Pistell owns one-half of the ordinary (voting) shares and Blackman, a foreign national and Bahamian resident, owns the other half of the ordinary shares of Vencap,** as well as 50% interest in all companies affiliated with Vencap, such as Intervent and Intercapital. Blackman is executive vice president, secretary and a director of Vencap. The district court so held (A951a). He has been active at board meetings and has executed numerous corporate documents (A1241a, 1246a, 1252a, 1266a, 2001a, 2004a, 2139a, 4240a).

The SEC's Contention: Defendant Vencap is "nominally" a Bahamian corporation but is really an "American" corporation.

The Facts: Neither IIT nor the SEC dispute the fact that Vencap is a corporation incorporated under the laws of the Commonwealth of the Bahama Islands (A9a). The SEC in its *amicus* brief, in an attempt to support its contention stated above, refers to Vencap as a "non-resident" Bahamian company and asks this Court to infer therefore that Vencap may not conduct its affairs in the Bahamas. Vencap's "non-resident" designation does not alter its right and ability to conduct business within and without the

* See Vencap's main brief (5), Pistell's reply brief (A-4), and Havens Wandless' reply brief (17).

** At the time of Vencap's incorporation and the subsequent IIT investment in Vencap, one-half of Vencap's ordinary shares were owned by Count Amoury de Reincourt, a French citizen residing in Geneva (A552a, 675a-76a, 1194a, 1236a, 1275a, 1367a).

Bahamas. The classification of a Bahamian company as "resident" or "non-resident" is made by the Bahamas Monetary Authority ("BMA") *solely* for exchange control purposes.*

No statutes or other laws or regulations in the Bahamas distinguish between resident and non-resident companies, (other than the Exchange Control Regulations), and a non-resident Bahamian company has the same rights, duties and obligations as a resident Bahamian company except as to its ability to deal in foreign exchange. They are both equally subject to service of process and suit in the Bahamas.

Thus, the fact that Vencap was classified as a "non-resident company" for Bahamian Exchange Control purposes does not mean that Vencap is prohibited from doing business in the Bahamas. Indeed, the first investment that Vencap made was in Out Island Airways, a Bahamian air carrier (A669a-70a, A1750a-54a). Moreover, Vencap's office

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* When application is made for the formation of a Bahamian company, BMA grants the company either "non-resident" or "resident" status. The significance of such designation relates only to the company's ability to deal in foreign exchange. BMA's policy is that where the company's trading and business will be transacted outside of the Bahamas, "non-resident" status will generally be granted to such a company. If, on the other hand, a Bahamian company desires to engage in active trade or business with persons or places within the Bahamas, "resident" status normally will be granted. "Non-resident" classification is a preferred status for a Bahamian company in that "non-resident" companies are permitted to retain dollar and other foreign exchange assets, either in or outside the Bahamas, and are required to convert dollars or other foreign exchange assets into Bahamian currency only in amounts needed to meet their operating expenses within the Bahamas. "Non-resident" companies are allowed to pay dividends or a return of capital in dollars or other foreign currency without BMA approval. "Resident" companies, on the other hand, generally may not, except with prior BMA approval, declare dividends convertible into dollars or other foreign exchange or pay a return of capital to non-Bahamian shareholders. See generally, Bahamian Exchange Control Regulations.

is in the Bahamas, its officers and directors reside in the Bahamas, and its principal bank accounts are also maintained there (A3318a-3365a, 4012a-4038a).

The SEC's Contention: (a) The agreement between IIT and Vencap was prepared in New York by IIT's New York counsel; (b) the specific terms of the Vencap preference shares were drafted in New York by Pistell's lawyer; and (c) the so-called three-page memorandum was drafted by "another of Pistell's New York attorneys" (SEC brief 7).

The Facts: (a) The IIT-Vencap agreement was prepared in Nassau, Bahamas, by IIT's attorneys, as is clearly demonstrated by one of the SEC's citations:

> By Mr. Kushner, an SEC attorney: "Q. I think you said off the record, correct me if I'm wrong, that the agreement was drafted by Willkie Farr, in Nassau" A(1825a).

The agreement not only was prepared in the Bahamas, but was also executed there (A505a-09a, 531a-32a, 1605a-06a). (b) The specific terms of the preference shares were drafted in Nassau, Bahamas, by IIT's counsel together with Bahamian counsel. Thereafter, preferred share provisions were adopted by the Vencap shareholders in the Bahamas. Vencap's New York attorneys did not even see these provisions, let alone review them, before their adoption (A504a).* (c) The three-page memorandum which Pistell prepared to memorialize his discussions with IIT regarding Vencap was prepared and typed in Nassau, Bahamas, by Vencap's Bahamian counsel, and was delivered by hand to IIT's attorneys in the Bahamas (A75a-77a, 667a-68a,

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* This Court's attention is directed to the complete and *accurate* statement of the facts relating to the IIT agreement and preference shares contained in Havens Wandless' main brief (13-14) and reply brief (6-7).

674a-75a, 678a-80a, 698a-99a). See Havens Wandless' main brief (13) and reply brief (7-8). It was *not* prepared by Pistell's New York attorneys, as the SEC asserts. Indeed, in one of the SEC's own citations (SEC Brief 7, at line 15) one of Vencap's attorneys answered a question relating to the three-page memorandum as follows: "THE WITNESS (Murphy): I don't know, sir, I didn't prepare it." (A683a).

The SEC's Contention: The SEC asserts that the funds invested in Vencap by IIT were derived from the sale of IIT's American securities, and that such funds had been transferred from a New Jersey bank to the Bahamian bank which thereafter paid $3,000,000 to Vencap in Nassau.

The Facts: The funds for the Vencap transaction were sent directly from a Luxembourg bank to a Bahamian bank, which then issued a $3,000,000 credit to Vencap at the closing in Nassau, Bahamas. One of the SEC's own citations (A4104a) is a telex sent by IIT to the Luxembourg bank, which contains the notation "Payment direct ODB to BCB Nassau".* This telex, as well as a subsequent telex (A4108a), makes it absolutely clear that payment was made directly from the Luxembourg bank to the Bahamas bank. One of Vencap's attorneys also testified that he was present at the bank in Nassau when the bank manager placed telephone calls to the Luxembourg bank and he heard that the funds were being transferred directly from the Luxembourg bank (A510a-512a). Shortly thereafter, at the closing in Nassau, Vencap was given a receipt by the Bahamas bank which states:

> "Transfer of Funds from O.D.B. (LUX) to Open New T.D. A/C" (A4237a).**

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* "ODB" is the Overseas Development Bank (Luxembourg), the sole cash custodian of IIT. "BCB" is the Bahamas Commonwealth Bank, Nassau, Bahamas.

** Thus, the evidence before the district court clearly demonstrated that the funds for the Vencap transaction were transferred

Moreover the SEC either knew or should have known that the funds actually used for the Vencap transaction were *not* transferred from the New Jersey bank, as testimony concerning the above-mentioned documents in a prior case,* as well as in this case, leaves no doubt that the funds were *not* transferred from the New Jersey bank as claimed by plaintiffs.

ARGUMENT

The Court Lacks Subject Matter Jurisdiction Over Plaintiffs' Federal Securities Law Claims.

The SEC's contention that the Federal securities laws are applicable to the case at bar is faulty in several respects. The thrust of the SEC's argument is that the application of those laws to the instant facts would not be violative of international law.** However, even assuming

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directly from the Luxembourg bank to the Bahamas bank, but the district court nevertheless held that the $3,000,000 which was paid to Vencap in Nassau had been transferred from the New Jersey bank (A954a-960a).

* The SEC's own attorneys were present during extended cross-examination of Robert Cassel, an officer of the New Jersey bank, who testified as a SEC witness before Judge Stewart in *SEC* v. *Vesco* (72 Civ. 5001). An extract of the relevant testimony of Cassel in that case is appended to this brief as Appendix "A." Cassel also testified as a witness for plaintiffs in the court below (A417a-478a).

** The SEC also contends that jurisdiction may be supported under several collateral theories. Thus, the SEC asserts that foreign transactions of foreign corporations managed by United States citizens are subject to the Federal securities laws, even if such transactions have no effect on American securities markets or American investors. However, the argument that jurisdiction may be predicated on citizenship has already been rejected by the courts. *SEC* v. *Kasser*, Civ. No. 74-90 (D.N.J. Filed March 12, 1975); *Garner* v. *Pearson*, 374 F. Supp. 591 (M.D. Fla. 1974). (*See also*

that the SEC is correct in that assertion, its brief begs, rather than answers, the key question before the Court. That question is clearly whether Congress *intended* the Federal securities laws to apply to the facts presented by the case at bar, and not whether international law would permit the application of those laws absent other considerations. *Leasco Data Processing Equipment Corporation* v. *Maxwell*, 468 F. 2d 1326 (2d Cir. 1972).

In *Schoenbaum* v. *Firstbrook*, 405 F. 2d 200 (2d Cir.), *rev'd in part on other grounds*, 405 F. 2d 215 (2d Cir. 1968) (en banc), *cert. denied sub nom. Manley* v. *Schoenbaum*, 395 U.S. 906 (1969), this Court held that

> . . . Congress intended the Exchange Act to have extraterritorial application in order to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities. 405 F. 2d at 206.

However, the SEC does not even address itself to the question of how the aforesaid purposes of the securities laws would be furthered by an application of those laws to the instant action.

Leasco Data Processing Equipment Corporation v. *Maxwell*, 468 F. 2d 1326 (2d Cir. 1972), and Havens Wandless' main brief p. 25).

Additionally, the SEC asserts that "Vencap's activities even if they had been conducted outside the United States, have had an impact upon the securities markets and upon investors within the United States" (SEC brief p. 20). However, the SEC does not explain what that impact is, nor how it came about. In fact, as Havens Wandless' main brief and reply brief have already demonstrated, the SEC's contention is completely without merit. Vencap's activities had neither a factual nor legal impact upon either American investors or American securities markets. (See Havens Wandless' main brief pp. 22-25 and 28-30; and Havens Wandless' reply brief pp. 12-15).

Moreover, the cases relied upon by the SEC in support of its position are cases which construed Federal and State statutes other than the securities laws.* Those statutes included the Lanham Act, the Jones Act, various Federal anti-trust laws, and a Florida statute concerning the sponge fishery in coastal waters. Surely cases construing such statutes can hardly shed light on the question of whether Congress intended the Federal securities laws to apply to the facts involved herein.

Indeed, the United States District Court for the District of New Jersey, per the Honorable Lawrence A. Whipple, Chief Judge, has recently held that Congress intended the securities laws to have extraterritorial application only when the transactions in question have a clear impact upon American investors or American securities markets; and that absent such a showing the Federal Courts do not have securities law jurisdiction over an action which alleges a scheme to defraud foreign entities, devised in the United States by Americans, and utilizing the means of interstate commerce to achieve its objectives. *SEC* v. *Kasser et al.*, Civ. No. 74-90 (D.N.J. filed March 12, 1975). As *Kasser* clearly disposes of the issues presented by the SEC's brief, and because that opinion is not yet reported, it is set forth in full text as Appendix "B" hereto.

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* The cases upon which the SEC relies are as follows: *Hellenic Lines Ltd.* v. *Rhoditis*, 398 U.S. 306 (1970); *Continental Ore Co.* v. *Union Carbide & Carbon Corp.*, 370 U.S. 690 (1962); *Lauritzen* v. *Larsen*, 345 U.S. 571 (1953); *Steele* v. *Bulova Watch Co.*, 344 U.S. 280 (1952); *Skiriotes* v. *Florida*, 313 U.S. 69 (1941); *United States* v. *Sisal Sales Corp.*, 274 U.S. 268 (1927); *American Banana Co.* v. *United Fruit Co.*, 213 U.S. 347 (1909).

CONCLUSION

For the reasons set forth herein, and in Murphy, Taylor and Havens Wandless' main and original reply briefs, the decision of the district court should be reversed, and this Court should enter an order directing the district court to dismiss the complaint herein for lack of subject matter jurisdiction.

Respectfully submitted,

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APPENDIX

APPENDIX A

Transcript* of *SEC* v. *Vesco et al.* (72 Civ. 5001) Extract from pages 2099-2102 and 2146-2147

*Cross Examination of Robert Cassell*** *by Mr. Grand:****

Q. I want you to look now at documents related to Vencap, particularly Plaintiff's Exhibit 192.***** Do you recall testifying yesterday that after receiving Plaintiff's Exhibit 192, a telex, the bank transferred $4,000,000 to BCB? Do you recall that? A. I believe I did, yes.

Q. And do you recall that Mr. Blank also elicited from you testimony that you did that without conversation either with ODB Lux. or conversations with Montreal Trust? A. That's correct.

Q. Now, this document, Plaintiff's Exhibit 192, is a telex directed to Mr. Lamboray at ODB Lux., is it not? A. Yes.

Q. And ANBT is simply copied on that document, is it not? A. That's correct.

Q. Now, I want you to look at the handwriting on the bottom—well, I guess midway in the document. It says

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* "ANBT" refers to the American National Bank and Trust Company of New Jersey.
"BCB" refers to the Bahamas Commonwealth Bank, Nassau, Bahamas.
"ODB Lux." refers to the Overseas Development Bank (Luxembourg).

** Cassel was at all times relevant a Vice President and trust officer of ANBT.

*** Paul R. Grand, Esq. of Poletti, Freidin, Prashker, Feldman & Gartner, Attorneys for Defendants IOS, Transglobal Financial Service, IIT Management, FOF Management, Venture Management, and Transglobal Growth Fund Management.

**** Plaintiff IIT's Exhibit 20 (A4104a).

t ODB to BCB Nassau, 10/16".* Do you see
sir.

lank:** I object. I don't think this hand-
was put into evidence yesterday.

dentify the handwriting? A. No; I cannot.
his: take a look at Plaintiff's Exhibit 194.***
telex from Brennan at your bank to EN
n. Do you see, about five lines down in that
says, "Payment was made direct by ODB to
et up an asset position." A. Yes; I do.
s that mean? A. That indicates to me that
ot made by American National, that it was
by ODB to BCB and all we were doing was
asset.
words, as with the Inter-American transac-
as not called upon either to make any pay-
or to make any delivery? A. That's cor-

ly were engaging in a bookkeeping function?

our books would properly reflect the trans-
e fund had engaged in? A. That is correct.

* * * * *

lank: Your Honor, I think this is so mis-
You have to look at Exhibit 192, the first
ph of 192, which says, "Value October 6,

the document is 10/6. Apparently this was a re-

Esq., an SEC attorney.
T's Exhibit 24 (A4108a).

1972, please withdraw dollars four million fr
funds held for the account of IIT in your acc
American National and transfer to Nassau."

Mr. Grand: The witness just stated th
money was not there.

Mr. Blank: The money was not where, Mr.

Mr. Grand: At ANBT, and it didn't mov
ANBT.

Mr. Blank: You are saying this 4 million-

The Court: Mr. Blank, let me read this
moment.

Mr. Blank: Here is Exhibit 192, your Ho

The Court: I thought there was testimony
today, or earlier, whether today or yesterday
same effect, that the money referred to in
192 was never at the American National Ba
Trust. Am I correct about that?

Mr. Grand: You are correct about that
Honor. The money was not in ANBT, did no
from there, moved from ODB Luxembour
ANBT is irrelevant to the transaction except
a few pieces of paper.

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APPENDIX B

Opinion of Whipple, *Chief Judge*

UNITED STATES DISTRICT COURT

DISTRICT OF NEW JERSEY

Civil Action No. 74-90

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

ALEXANDER KASSER, STEPHEN E. MOCHARY, TECHNOPULP INCORPORATED, CHURCHILL FOREST INDUSTRIES (MANITOBA) LTD., CHURCHILL PULP MILL LTD., JAMES M. BROWN, JR., CHESTER CHASTEK, RIVER SAWMILLS COMPANY, and BLUE CONSTRUCTION CORPORATION,

Defendants.

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Appendix B

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570 Broad Street
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WHIPPLE, *Chief Judge*

The plaintiff Securities and Exchange Commission instituted this action for injunctive and other relief against nine individual and corporate defendants. As set forth in detail *infra,* the complaint alleges numerous violations of Section 17(a) of the Securities Act of 1933, 15 U.S.C. §77q(a), and Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), together with Rule 10b-5 thereunder, 17 CFR 240. 10b-5. Additionally, there is a cross-claim in the cause which is not material at this stage of the proceedings.

With the exception of Alexander Kasser, who has yet to be served with process, all of the defendants have moved for dismissal of the complaint pursuant to Fed. R. Civ. P. 12(b)(1), asserting lack of subject matter jurisdiction. Should this Court deny those motions, defendants Brown,

Appendix B

Chastek, River Sawmills Co. and Blue Construction Corporation have filed several alternative motions of which only the following are presently under consideration: (1) that the Manitoba Development Corporation (the allegedly defrauded Canadian entity) be joined as a party, or failing such joinder, that the action be dismissed for failure to join an indispensable party; and (2) that plaintiff's demand for an accounting and restitution by defendant Brown to the Manitoba Development Corporation be stricken. Consideration of the remaining motions has been deferred pending disposition of the applications which are presently before the Court.

I. The Complaint

For the purposes of this motion, all well pleaded allegations of the complaint must be accepted as true. *Sabolsky* v. *Budzanoski*, 457 F.2d 1245, 1249 (3rd Cir.), *cert. denied*, 409 U.S. 853 (1972); *Lasher* v. *Shafer*, 460 F.2d 343, 344 (3rd Cir. 1972).

Count I of the complaint indicates that during the mid-1960's the Canadian provincial government of Manitoba sought to interest private enterprise in the creation of a forestry complex at the Pas, Manitoba. An organization called the Manitoba Development Fund (hereinafter M.D.F.), now known as the Manitoba Development Corporation, was created by the government to oversee the development and financing of the project. In 1965 Monoca A.G., a Swiss corporation allegedly owned and controlled by defendant Alexander Kasser, a United States citizen, received an option to develop the complex. Oskar Reiser, a Swiss national, negotiated the option on behalf of Monoca A.G. which, according to the complaint, purported to repre-

sent diverse European and American investors in the pulp and paper industry.

In January 1966, negotiations were held in New York, New York between Reiser and Manitoba officials concerning plans for the forestry project. On February 24, 1966 the Province of Manitoba signed an agreement in Canada with defendant Churchill Forest Industries (Manitoba), Ltd. (hereinafter C.F.I.). Under that contract C.F.I. was granted timber concessions in exchange for its commitment to develop, own, and operate the forestry complex. C.F.I. had been incorporated in Canada and was represented to be a subsidiary of Monoca. The defendant Kasser, however, allegedly concealed his complete ownership of both corporations.

The complaint asserts that in furtherance of the scheme defendant Kasser and others fraudulently induced the M.D.F. to enter an investment contract with C.F.I. That contract, entitled a Master Finance Agreement, was negotiated partially in New York but was executed in Canada on November 19, 1966. The agreement provided for the establishment of a forestry complex to be owned and operated by C.F.I. Financing for the project was to emanate principally from the M.D.F., but C.F.I. was required as a condition of the agreement to furnish substantial amounts of its own invested equity capital. The Master Finance Agreement defined said equity capital as money paid in cash for shares of C.F.I. stock, and expressly excluded the use of retained earnings and government grants under the so-called Canadian Area Development Incentives Act (hereinafter A.D.A.).

The very substance of the fraud upon which the complaint is based stems from alleged violations of this provision in the Master Finance Agreement The defendants,

according to the complaint, used elaborate and complex methods of concealing the true nature of the purported equity capital investment in C.F.I.

By way of background, the complaint avers that Kasser's only role in the preliminary negotiations was that of president of the defendant Technopulp Incorporated (hereinafter Technopulp), a New Jersey corporation. When the Master Finance Agreement was signed, the M.D.F. approved a May 1966 engineering and management services contract signed by Kasser for Technopulp and Reiser for C.F.I., which was represented by defendants to be an arms-length transaction. Furthermore, the M.D.F. executed an agreement with Monoca A.G. in which Monoca represented that it would invest a minimum of $5,000,000 in C.F.I. stock by March 31, 1971. As in the Master Finance Agreement, the consideration for these shares was not to come from retained earnings of C.F.I. or from A.D.A. grants. Monoca claimed that it had a substantial interest in C.F.I. and that it would fully disclose any change in corporate ownership. Mr. Kasser was represented as having only a minor shareholder interest in Monoca. This so-called "Monoca Agreement", like the other contracts with the M.D.F., was not executed in the United States.

The complaint alleges further that, in employment of the scheme, defendants Kasser and Stephen Mochary, a New Jersey attorney, incorporated the defendant Churchill Pulp Mill, Ltd. (hereinafter Churchill Pulp) in Nevada during June 1969. On June 15, 1969 Technopulp and C.F.I. were consolidated into Churchill Pulp as wholly owned subsidiaries, a structural change which according to the allegations was never disclosed to the M.D.F. Through this device, it is asserted that the defendants

were able to "channel" loan disbursements from the project into purported investments in C.F.I. stock.

It appears that Churchill Pulp, through an assignment to it by Kasser of his rights to C.F.I. stock, became responsible for investing the $5,000,000 in equity capital to which Monoca had agreed in the Monoca contract. This assignment was allegedly confirmed in a letter mailed by Mochary from Montclair, New Jersey to Kasser, whose address is not given. It is alleged that the M.D.F. was never informed of either assignment. As indicated *infra,* Churchill Pulp was eventually to hold the C.F.I. stock through its nominee, the Swiss Bank Corporation.

Paragraph 33 of the complaint contains allegations as to the "mechanics" of funneling M.D.F. money into C.F.I. stock in order to satisfy the requirements of the Master Financing Agreement. The defendants are claimed to have engaged in direct "recycling" of monies advanced as loans by the M.D.F. The scheme allegedly operated in the following manner: After having requisitioned certain monies from the M.D.F. to purportedly pay development costs, C.F.I. would deposit money in the Royal Bank of Canada At Winnipeg, Manitoba in an amount equal to the required percentage of equity investment for the requisition. When the Royal Bank confirmed that it received a deposit designated for stock purchases, the Canadian C.F.I. attorney would certify to the M.D.F. that such funds were received and would issue an appropriate amount of C.F.I. stock in the name of the Swiss Bank Corporation. The M.D.F. would then authorize disbursements of the loan requisition, and C.F.I. would complete the cycle by issuing debentures to the M.D.F. for the loan. While paragraph 33 does not *specifically* allege that the monies deposited in the Royal Bank were part of the same funds disbursed

by the M.D.F., there are generalized allegations to that effect contained elsewhere in the complaint. It is thus assumed for the purpose of this motion that the same monies paid to C.F.I. in Canada were henceforth transferred to the Royal Bank as purported equity investments.

Another aspect of the scheme involved the New York office of the Swiss Bank Corporation into which defendants Kasser and Mochary allegedly channeled funds from the middle of June, 1969 until March of 1970. The Swiss Bank was instructed in letters from Mochary to transfer this money by wire from New York to the Royal Bank of Canada in Winnipeg, Manitoba, for the purchase of C.F.I. stock in the Swiss Bank's name. The Swiss Bank held this stock as nominee for Churchill Pulp, whose beneficial ownership was never disclosed to the M.D.F. The complaint asserts that over $3,000,000 in purported stock purchases were routed from Mochary's Montclair, New Jersey office to the New York conduit, and then by wire to the Royal Bank in Winnipeg. Approximately $1,700,000 of this sum was allegedly contributed by Technopulp in the form of dividends to its parent, Churchill Pulp.

The first count of the complaint indicates that a total of more than $38,000,000 was advanced by the M.D.F. to C.F.I. in the form of "loan disbursements and working capital loans". Defendants issued and delivered C.F.I. debentures to the M.D.F. in the total face amount of $40,700,000. In late 1970, C.F.I. defaulted on its interest payments and a receivership action was instituted in January, 1971. The M.D.F. was awarded all of its remaining assets by the Court of Queens Bench in November, 1973.

Count II of the S.E.C.'s complaint alleges similar fraudulent acts on the part of the following defendants: Kasser, Mochary, James M. Brown, Jr., Chester Chastek, River

Appendix B

Sawmills Company, a Delaware corporation (hereinafter River) and Blue Construction Corporation, a Delaware corporation (hereinafter Blue). The events contained in this Count occurred from January 1968 until January 16, 1974, the date of the complaint.

The details of the alleged fraud follow a pattern similar to the acts described in the first count. In early 1968, the M.D.F. began to explore the economic feasibility of constructing a large sawmill at the Pas, Manitoba. For various reasons, the M.D.F. insisted on independent ownership of this project. In the summer of 1968, Kasser brought together the M.D.F. and defendant James M. Brown, Jr., who was chairman of a well-established, successful lumber operation called the Pact River Company which owned sawmills in the United States and Canada. Together with Kasser, Brown represented to the M.D.F. that he was willing to invest substantial sums of his own money and to assume the ownership and development of the sawmill.

In January, 1968, according to the complaint, defendants Kasser, Brown and Chester Chastek had met in Montclair, New Jersey to formulate a plan for developing the sawmill. Kasser and Brown agreed that the project would be a joint venture and that Kasser would lend Brown one-half of the front money to promote the operation. Furthermore, River would own the sawmill while Blue would construct a smaller mill for Churchill Pulp and would be the parent corporation for River.

In February, 1968, Kasser sent Brown a check for $25,000 to assist in the formation of Blue and was given the option to convert this loan into half the equity securities of Blue. During the same month, C.F.I. contracted with Blue in Montclair, New Jersey for the construction of a small sawmill at the Pas for the sum of $3,900,000. At a Sicily,

Italy meeting in April, 1968, the defendants agreed to apply profits from the small sawmill toward equity in the larger project, with the balance of such equity to be provided through a Swiss bank loan. In late June, River entered into a construction contract with Blue for the large sawmill. The complaint does not specify where this contract was executed.

On September 25, 1968, in Montclair, New Jersey, Kasser, Brown and Chastek caused River to enter into a Master Finance Agreement with the M.D.F. for development of the large sawmill project. As in its agreement with C.F.I., the M.D.F. promised to furnish the major portion of financing in installments which would be matched by proportionate contributions from River's equity. River also agreed to apply for an A.D.A. grant. Funds from this grant, as well as retained earnings, were expressly proscribed as contributions to River's equity capital. In negotiating with the M.D.F., the defendants represented that River was an affiliate of Brown's Pack River Company. To substantiate that representation, special stationery was allegedly printed in New Jersey for Pack River, denoting the defendant River as an affiliated company.

According to the complaint, the defendants fraudulently requisitioned from the M.D.F. $7,899,356 in four installments during the period from March 11, 1969 until March 26, 1970. Each time a disbursement was sought, the defendants are alleged to have created the false appearance that an additional increment in equity funds had been received by River. For example, the complaint asserts that on or about March 11, 1969, the defendant Chastek telephoned the M.D.F. from Spokane, Washington and falsely represented that River had received the $500,000 in stock purchases necessary under the Master Finance Agreement

for requisition of funds. He later confirmed that representation by letter mailed from Spokane to Winnipeg. To substantiate the claim, $500,000 had been deposited in River's account with the Royal Bank Corporation loan and other money from Blue bank accounts in Seattle, Washington. Following the deposit by M.D.F. of $2,000,000 in River's Canadian account, Chastek directed the Royal Bank by telephone to transfer the funds to River's account at the Chemical Bank New York Trust Company in New York City. When the money was received by wire in New York, Alexander Kasser's personal accountant directed that it be transferred from River's account to that of Blue Construction Corporation. Blue thereupon repaid the Swiss Bank loan which originated the transaction.

Similar requisitions were allegedly obtained in August and October, 1969, and in March of 1970. On two occasions, the initial $500,000 placed in River's account was obtained from the account of Blue at the Swiss Bank's New York office. The source of Blue's funds is alleged to have been a previous M.D.F. advance. With respect to the August disbursement, the source of that initial sum was a loan from Technopulp Machinery, Inc., a New Jersey corporation controlled by Alexander Kasser. The complaint alleges that in each transaction, the M.D.F. funds eventually ended up in Blue's New York account.

Pursuant to this scheme, the defendants issued and delivered to the M.D.F. debentures of River with a face amount of approximately $9,600,000. The equity securities allegedly issued by River were valued at approximately $9,600,000.

When the defendants sought another requisition in April, 1970, the M.D.F. refused to release the monies until River had accounted for the loans already received. Although defendants assertedly attempted to create a false appear-

ance of equity investment similar to those described above, the funds were never released. The River operation was shut down in June, 1970. Because River defaulted on its interest payments to the M.D.F. later that year, a receivership action was instituted in the Court of Queen's Bench in January, 1971. M.D.F. was awarded all of River's remaining assets by that court in November, 1973. It is alleged that the simultaneous defaults of River and C.F.I. were in furtherance of the scheme designed by the defendants.

II. Subject Matter Jurisdiction

This Court's determination of the various motions to dismiss is dependent upon the resolution of a singular yet delicate issue: whether Congress, in enacting the securities legislation, intended to confer upon the federal courts jurisdiction to entertain actions involving the particular facts alleged in the Commission's complaint.

The basic thrust of defendants' argument is that the transactions alleged in the complaint were essentially foreign in nature having no significant impact on either the domestic investing public or the domestic securities markets. Absent the existence of such impact, it is urged that this Court is deprived of subject matter jurisdiction notwithstanding the various allegations of miscellaneous activities occurring within the United States. Conceding that there has been no direct impact,[1] the Commission nevertheless asserts that the federal courts are vested with jurisdiction where a scheme to defraud foreign entities is

[1] During oral argument on the motions, Mr. Sullivan, counsel for the Commission, acknowledged "Again, I will say that as far [as] direct impact on our securities markets are concerned, there is no direct impact."

devised in this country by Americans who utilize the means of interstate commerce to achieve their objectives. For the reasons hereinafter stated, it is concluded that the complaint fails to invoke the subject matter jurisdiction of this Court; therefore, the defendants' motions to dismiss will be granted.

At the heart of the jurisdictional issue is of course the language of the statutes under which this action was instituted. Section 17(a) of the Securities Act of 1933 (hereinafter Securities Act) provides:

> (a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—
>
> (1) to employ any device, scheme or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Section 10(b) of the Securities Exchange Act of 1934 (hereinafter Exchange Act), also cited in the complaint, contains a similar provision making it unlawful for any person

> by the use of any means or instrumentality of interstate commerce . . .

> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered; any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.[2]

In support of its position, the Commission emphasizes the words "any person" and "any securities" in those statutes, the reference to "foreign commerce" [3] in the preambles to each, and the definition of interstate commerce in each as including trade, commerce, transportation, or communication "between any foreign country and any State." Securities Act §2(7); Exchange Act §3(a)(17). On the surface, the cited language reveals *only* that, when measured against the facts in this case, Congress did not prescribe an immediate jurisdictional solution to this problem of transnational law. As the Court of Appeals for the Second Circuit observed in the noted case of *Leasco Data Processing Equipment Corp.* v. *Maxwell*, 468 F.2d 1326, 1334 (2nd Cir. 1972):

> [T]he language of §10(b) of the Securities Exchange Act is much too inconclusive to lead us to believe that Congress meant to impose rules governing conduct

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[2] Since the statute is not self-executing, Rule 10b-5 was promulgated by the Commission. Jurisdiction, however, is unaffected by the language of that Rule.

[3] For example, the preamble to the Securities Act states that the Act is intended to "provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof and for other purposes."

> throughout the world in every instance where an American company bought or sold a security.

At this juncture, it should be noted parenthetically that the vast majority of decisions in which similar jurisdictional issues have arisen, many of which are cited *infra*, involved section 10(b) of the Exchange Act and Rule 10b-5. The jurisdictional principles applicable to those provisions are identical to the principles which relate to section 17(a) of the Securities Act; hence any reference herein to one statute shall be deemed applicable to the other.

As early as 1909, the United States Supreme Court announced a presumption against the extraterritorial application of federal legislation. In *American Banana Co.* v. *United Fruit Co.*, 213 U.S. 347 (1909), the Court found that the Sherman Antitrust Act could not be applied to an action between two American corporations in which the plaintiff did not allege that defendants' activities had a substantial effect within the United States. In *United States* v. *Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945), Judge Learned Hand reiterated that

> [w]e should not impute to Congress an intent to punish all whom its courts can catch, for conduct which has no consequences within the United States.

148 F.2d at 443. *See also Blackmer* v. *United States*, 248 U.S. 421, 437 (1937); *Restatement (Second) of the Foreign Relations Law of the United States* §38 (1965). In the realm of economic regulation, where Congress is primarily concerned with domestic affairs, the presumption against extraterritorial application is particularly strong. *See Foley Bros., Inc.* v. *Filardo*, 336 U.S. 281, 285 (1949). It is

now abundantly clear, however, that the presumption may be rebutted so as to permit the assumption of jurisdiction where there are allegations that the extraterritorial conduct produced domestic impact which is violative of federal law. *United States* v. *Aluminum Co. of America, supra; Strassheim* v. *Daily*, 221 U.S. 280, 285 (1911).[4]

The Commission urges this Court to utilize the jurisdictional principle embodied in the *Restatement (Second) of Foreign Relations Law of the United States* §17(a) (1965):

> A state has jurisdiction to prescribe a rule of law (a) attaching legal consequences to conduct that occurs within its territory, whether or not such consequences are determined by the effects of the conduct outside the territory. . .[5]

The Court agrees that on its face the *Restatement* approach would appear to permit the exercise of jurisdiction where,

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[4] This is the so-called "objective" territorial principle of jurisdiction found in international law. As commonly construed, the objective principle requires that defendants' conduct was both intended to and did produce effects within the forum state. It is reflected in the *Restatement (Second) of Foreign Relations Law* at §18. The various principles have been widely discussed in the context of securities regulation and need not be dealt with here. *See, e.g.*, Note, 7 Vand. J. Trans. L. 770 (1974); Note, 8 Tex. Intl. L.J. 430 (1973); Note, 10 Colum. J. Trans. L. 150 (1971); and the multitude of citations therein. Noteworthy is the observation frequently made that the presumption having caused "harsh" results in earlier cases, has been weakened by subseqent decisions such as *Alcoa*. As the analysis contained *infra* discloses, the Court agrees that jurisdiction has been expanded to include a variety of situations, but the presumption nevertheless survives. *See Leasco Data Processing Equipment Co.* v. *Maxwell*, 468 F.2d 1326 (2d Cir. 1972); *Vanity Fair Mills Inc.* v. *T. Eaton Co.*, 234 F.2d 633 (2d Cir.) *cert. denied*, 352 U.S. 871 (1956).

[5] This section states the "subjective" territorial principle of jurisdiction. *See, e.g.* Note, 69 Colum. L. Rev. 94 (1969) and citations therein.

as here, conduct has occurred within United States borders. As defendants assert, however, it is essential to distinguish between the permissible limits of jurisdictional power recognized by international law and the extent to which Congress has chosen to implement that power. In short, the question of extraterritorial application in this case is one of municipal, rather than international law. *United States* v. *Aluminum Co. of America, supra* at 148 F.2d 443. In *Leasco Data Processing Equipment Corp.* v. *Maxwell, supra,* the Court considered the *Restatement* in depth and observed:

> Conduct within the territory alone would seem sufficient from the standpoint of jurisdiction to prescribe a rule. It follows that when, as here, there has been significant conduct within the territory, a statute cannot properly be held inapplicable simply on the ground that, absent the clearest language, Congress will not be assumed to have meant to go beyond the limits recognized by foreign relations law. . . .
>
> . . . .
>
> Up to this point we have established only that, because of the extensive acts alleged to have been performed in the United States, considerations of foreign relations law do not preclude our reading §10(b) as applicable here. The question remains whether we should.

468 F. 2d at 1334-35.

With this background in mind, it is essential to juxtapose the underlying purposes of the securities fraud legislation in order to place the facts of this case in their proper perspective. It is beyond dispute that the principal

objective is protection of *American* purchasers who are exposed to fraudulent offers or sales of securities in interstate commerce.

In *Shoenbaum* v. *Firstbrook*, 405 F.2d 200 (2d Cir. 1968), the Second Circuit considered this objective in terms of its trans-national application:

> We believe that Congress intended the Exchange Act to have extraterritorial application in order to protect domestic investors who have purchased foreign securities on American Exchanges[6] and to protect the domestic securities market from the effects of improper foreign transactions in American securities.

405 F.2d at 206.

The latter part of that statement is reflective of defendants' position in the instant case: Congress did not intend to confer jurisdiction on the federal courts over an essentially foreign transaction in American securities *unless* that transaction has an impact on domestic investors or securities markets. This Court agrees with that contention.

Curiously, both plaintiff and defendants rely on many of the same authorities to support their respective claims. The Commission asserts that applicable precedent requires only that there be a use of the jurisdictional means in connection with fraudulent conduct, regardless of the nonexistence of impact or effects in this country. As defendants suggest, a careful review of comparable decisions in which jurisdiction has been sustained discloses a requisite effect or impact upon American investors or securities

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[6] In *Leasco*, *supra*, the Court reviewed the statute and legislative history and concluded that the protection is not limited to the organized markets. In light of that extensive review, this Court need not reexamine the legislative history.

markets *in addition to* the use of interstate commerce facilities by the defendants. Hence these cases are clearly distinguishable since there is concededly no impact in the case at bar. *See eg., Securities and Exchange Commission* v. *United Financial Group, Inc.*, 474 F.2d 354 (9th Cir. 1973); *Shoenbaum* v. *Firstbrook*, 405 F.2d 200 (2d Cir. 1968), *rev'd in part on other grounds en banc*, 405 F.2d 215, *cert. denied* 395 U.S. 906 (1969).

In *Leasco Data Processing Corp.* v. *Maxwell, supra*, upon which all of the parties heavily rely, the court clarified its view thusly:

> [W]e doubt that impact on an American company and its shareholders would suffice to make the statute applicable if the misconduct had occurred solely in England, we think it tips the scales in favor of applicability when substantial misrepresentations were made in the United States.

468 F.2d at 1337. *See also Travis* v. *Anthes Imperial Ltd.*, 473 F.2d 515, 526 n. 21 (8th Cir. 1974), in which Canadian defendants had defrauded American shareholders of a Canadian corporation:

> [T]he transaction involved is one which to a significant degree has taken place within the United States, has caused injury to United States investors, and the jurisdiction is grounded on more than an incidental use of the mails or the facilities of interstate commerce.

Cf. *Roth* v. *Fund of Funds, Ltd.*, 405 F.2d 421 (2d Cir. 1968), *cert. denied*, 394 U.S. 975 (1969). Although the Commission vigorously urges that it is controlling, *Securities and Exchange Commission* v. *Gulf Intercontinen-*

tal Finance Corp., 223 F. Supp. 987 (S.D. Fla. 1963) is likewise distinguishable. The Court there found that, while no Americans had purchased stock as a result of the allegedly fraudulent offers, American investors had undoubtedly been exposed to the offers on a wide scale. Jurisdiction was thus proper since the Court found that the securities laws clearly apply to the offer of foreign securities within the United States. The complaint in this case is utterly devoid of similar allegations.

Defendants have alluded to the following persuasive language in *Investment Properties International, Ltd.* v. *I.O.S., Ltd.*, CCH Fed. Sec. L. Rep. ¶93,011 at 90,727 (S.D. N.Y. 1971) *aff'd mem*, Docket No. 71,572 (2d Cir. 1971):

> [A]lthough the behavior of a defendant, including its connection to the United States and to the domestic securities market and exchanges, is relevant in deciding whether an extraterritorial transaction comes within the jurisdiction of the Act, the main consideration appears to be: Does the transaction have some significant impact on the domestic securities market or on domestic investors, and is extraterritorial application therefore necessary to protect securities trading in the United States and/or American investors?

It is of course clear in the case *sub judice* that there is no showing of domestic impact caused by the allegedly fraudulent conduct of the defendants. On this basis alone, it cannot fairly be said that Congress intended to reach these transactions in the anti-fraud legislation. The Court's inquiry, however, must go one step further in order to determine whether the activities conducted by the American defendants in the United States, though concededly without effect here, were sufficient to give rise to jurisdiction.

Appendix B

In the opinion of this Court, the essentially foreign nature of the transaction here at issue is not materially altered by the various miscellaneous acts allegedly committed locally in furtherance of the scheme. To reiterate, those activities include the following: (1) meetings were held in the United States as part of negotiations; (2) a New York office of the Swiss Bank Corporation was used as a conduit for the transfer of funds, although only a relatively small proportion of those funds was actually so transferred through that bank; (3) one Master Finance Agreement was executed in New York; (4) defendants incorporated most of the corporations in this country and discussed their plans in New Jersey; and, (5) the means of interstate commerce (mails, telephone and telegraph) were employed in furtherance of the scheme. While these domestic activities, in particular the use of American corporations, cannot be ignored, the Court is nonetheless satisfied that the case before it involves essentially foreign transactions without impact in this country.

A single Canadian entity has invested in debt securities of closely held corporations. The securities were never traded in or even exposed to American markets or investors. Moreover, the securities were given in exchange for funds to be used exclusively in the development of a Canadian forestry complex. The principal issuer of those securities was a Canadian corporation which allegedly transferred the M.D.F. money directly to a Canadian Bank, without the use of American conduits. All but one of the contracts involved were executed outside the country. The existence of American defendants notwithstanding, this Court concludes that it was not the intent of Congress to include essentially foreign transactions such as these within the ambit of the federal anti-fraud legislation. See *Invest-*

ment Properties International, Ltd. v. *I.O.S., supra; Manus* v. *Bank of Bermuda, Ltd.*, CCH Fed. Sec. L. Rep. ¶93,299 (S.D. N.Y. 1971); *Finch* v. *Marathon Securities Corp.*, 316 F. Supp. 1345 (S.D. N.Y. 1970); *Sinua, Inc.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 48 F.D.R. 385 (S.D. N.Y. 1969); *Kook* v. *Crang*, 182 F. Supp. 388 (S.D. N.Y. 1960).

In conclusion, it should be noted that the Court recognizes the seriousness of the allegations against these defendants and the potential ramifications of this decision. Furthermore, it is entirely possible that there exists a legitimate governmental interest in applying the securities legislation to Americans who fraudulently issue securities in essentially foreign transactions. However, the Court remains convinced that this is not the proper forum for adjudication of the controversy. Accordingly, the motions to dismiss will be granted.

III. Remaining Motions

In light of the Court's disposition of the jurisdictional motions, it is of course unnecessary to consider any of the remaining motions in the cause.

Defendants shall submit an appropriate order.

No Costs.

/s/ Lawrence A. Whipple
Lawrence A. Whipple
Chief Judge, U.S.D.C.

Dated: March 11, 1975

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Re: IIT, an International Investment Trust, et al. v. Vencap, Ltd., et al., Docket Nos. 74-1969 and 74-2366

r Mr. Fusaro:

I am sending herewith for filing copies of our brief in response to the SEC amicus brief, pursuant to the order of the Honorable liam H. Timbers, United States Circuit Judge, dated March 18, 1975, ch permitted us to file such brief not later than March 24, 1975, at .M.

I hereby certify that a messenger from my office has today en a shuttle airplane to Washington, D.C. to personally serve the urities and Exchange Commission with copies of our brief. I also tify that copies of our brief have been hand delivered to all parties this appeal.

Pursuant to Rule 24(d) of the Federal Rules of Appellate cedure, proof of service on the Securities and Exchange Commission other parties to the appeal will be filed promptly hereafter.

Very truly yours,

Peter K. Leisure

closures

Service of 2 copies of this within
Reply Brief is admitted this
24 day of March 1971

ATTORNEY FOR

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